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In the Supreme Court of the United States

OCTOBER TERM, 1929

FAWCUS MACHINE COMPANY, PETITIONER

v.

THE UNITED STATES

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS

MEMORANDUM FOR THE UNITED STATES

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OPINION BELOW

The memorandum opinion of the Court of Claims (R. 28) has not yet been officially reported.

JURISDICTION

The judgment sought to be reviewed was entered on November 4, 1929. (R. 28.) The petition for certiorari was filed February 4, 1930. (R. 28.) The jurisdiction of this Court is invoked under Section 3 (b) of the Act of February 13, 1925.

QUESTION PRESENTED

In computing the invested capital for the year 1919, of a corporation whose books of account are kept on the accrual basis, should its invested capital as at the close of the year 1918 be reduced by the amount of income and profits taxes imposed for the year 1918 by the Revenue Act of 1918 which was enacted on February 24, 1919?

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of the Revenue Act of 1918 (c. 18, 40 Stat. 1057, 1092), are as follows:

> SEC. 326. (a) That as used in this title the term "invested capital" for any year means (except as provided in subdivisions (b) and (c) of this section);
>
> (1) Actual cash bona fide paid in for stock or shares;
>
> (2) Actual cash value of tangible property, other than cash, bona fide paid in for stock or shares, * * *;
>
> (3) Paid-in or earned surplus and undivided profits; not including surplus and undivided profits earned during the year;
>
> * * * * *
>
> (b) As used in this title the term "invested capital" does not include borrowed capital.
>
> * * * * *
>
> (d) The invested capital for any period shall be the average invested capital for such period * * *.

Section 1207 of the Revenue Act of 1926 (c. 27, 44 Stat. 9, 129) provides as follows:

> SEC. 1207. The computation of invested capital for any taxable year under the Revenue Act of 1917, the Revenue Act of 1918, and the Revenue Act of 1921, shall be considered as having been correctly made, so far as relating to the inclusion in invested capital for such year of income, war-profits, or excess-profits taxes for the preceding year, if made in accordance with the regulations in force in respect of such taxable year applicable to the relationship between invested capital of one year and taxes for the preceding year.

On February 17, 1919, the Treasury Department promulgated Treasury Decision 2791, which provided as follows:

> For the purpose of determining invested capital under Title II of the act of October 3, 1917, income and excess-profits taxes shall be deemed to have been paid out of the net income for the taxable year for which such taxes are levied. Amounts payable on account of income and excess-profits taxes for any year may be included in computing surplus and undivided profits for the succeeding year only for the proportionate part of the year represented by the period of time between the close of the taxable year and the date or dates upon which such taxes become due and payable.

The substance of this Treasury Decision was included in Article 845 of Regulations 45, issued under the Revenue Act of 1918.

STATEMENT

Petitioner is a Pennsylvania corporation and was engaged in business during the years 1918 and 1919. (R. 24, 26.) It kept its books of account and filed its income and profits tax returns on the accrual basis. (R. 26.) In its income and profits tax return for the year ended December 31, 1919, petitioner did not make any reduction in its invested capital for that year on account of income and profits tax assessed and paid in 1919 for the year 1918. (R. 25, 26.) During the taxable year 1919 at the time each installment of 1918 income and profits taxes of petitioner became due and payable, it had on hand surplus or undivided profits earned during the taxable year 1919, more than sufficient to pay such installment. (R. 26.)

The Commissioner of Internal Revenue, in auditing the petitioner's 1919 return, determined that its invested capital for the year 1919 should be reduced by the amount of taxes on income and profits earned in the year 1918, as of the dates in 1919 when the respective installments of taxes became due and were paid. (R. 26.) This was accomplished by determining the average deduction for the year and reducing earned surplus as of January 1, 1919, by that amount. (R. 26.)

The petitioner claims a refund of $1,597.85 alleged to have been overpaid for the year ended

December 31, 1919, and contends that the Commissioner of Internal Revenue was in error in reducing its invested capital for one year on account of income and profits taxes for the preceding year.

ARGUMENT

The Government does not oppose the petition for certiorari in this case.

If the petitioner's income and profits taxes for the year 1918 accrued during the year 1918, there is no contention that the reduction of the petitioner's invested capital was not properly made. The petitioner's position is that these taxes could not have accrued during 1918, because the Revenue Act of 1918 was not enacted until February 24, 1919, and the petitioner further contends that if the taxes did not accrue in 1918 they could not be deducted from invested capital for the following year.

The Court of Claims in its memorandum opinion in this case (R. 28) said that the question was controlled by four decisions, which it cited. These cases are *United States* v. *Yale & Towne Mfg. Co.* (*United States* v. *Anderson*), 269 U. S. 422; *Nichols* v. *Sylvester Co.*, 16 F. (2d) 98 (C. C. A. 1st), certiorari denied, 273 U. S. 760; *Bowers* v. *Kaufman & Co.*, 18 F. (2d) 69 (C. C. A. 2d); *Appeal of Russell Wheel & Foundry Co.*, 3 B. T. A. 1168.

We do not feel that the first and third of these cases, at least, are decisive of the point made by petitioner. They decide only that a tax accrues during the year for which it is levied, when the Revenue Act levying the tax is passed before the

end of the year for which the tax is levied. They do not consider the problem of when the taxes on 1918 income and profits accrued, in view of the fact that the Revenue Act of 1918 was not passed until February 24, 1919. The question seems to be involved in *Nicholas* v. *Sylvester Co., supra*, but the precise point was not considered in the opinion of the court. *Appeal of Russell Wheel & Foundry Co.*, also cited by the Court of Claims, is referred to, *infra*, p. 8.

In *United States* v. *Norwich & W. R. Co.*, 16 F. (2d) 944, the District Court of Massachusetts adopted substantially the view which the petitioner now presents, and the Government did not appeal from its decision.

But we do not admit that the contentions of the petitioner are correct. Until February 24, 1919, the Revenue Act of 1917 was in force. The effect of the Revenue Act of 1918 was simply to amend the Revenue Act of 1917. It thus seems arguable that as the taxes under the 1917 Act for the year 1918 accrued in 1918, and as this Act was later amended by retroactive legislation, the tax under the Act as amended may be treated as if it accrued in place of the tax previously provided for.

Revenue Acts may be, and they frequently have been, amended by retroactive legislation after the year for which the tax is levied. (*Cf.* the dissenting opinion in *Untermyer* v. *Anderson*, 276 U. S. 440, 447–448.) The amendment may decrease or increase the tax. Nevertheless, such tax as may be levied must be treated as if it accrued in the year for

which it is levied (where books are kept on the accrual basis) if income is to be clearly reflected. Books of account may readily be amended accordingly. We submit, therefore, that the date of the passage of the Act is immaterial.

Shuster & Co., Inc., v. *Williams, Collector*, 283 Fed. 115 (C. C. A. 7th), relied upon by the petitioner, seems distinguishable. There a State law was passed in 1919 levying a soldiers' bonus tax upon 1918 incomes. It was held by the court that the tax did not accrue until 1919, but in that case the tax imposed was not simply an amendment of an already existing tax but was a wholly independent tax, having no counterpart, either in earlier or in later taxing legislation.

Moreover, the method of computing invested capital followed in this case was that prescribed by Treasury Decision 2791 (p. 3, *supra*). The statute contained no provision which this Decision contravened. We submit that the Decision laid down a reasonable rule for the treatment of taxes in the calculation of invested capital, a matter which was not particularly adverted to in the statute and which was within the province of the Commissioner's discretion. We contend that the matter should be governed by this regulation and that the question when the taxes accrued is not necessarily involved.

In Section 1207 (p. 3, *supra*) of the Revenue Act of 1926, Congress made specific reference to the method of computing invested capital under

the Revenue Act of 1918. The Board of Tax Appeals, in one of the decisions relied on by the Court of Claims in the instant case, took the view that the action of Congress in passing this Section was a direct approval of the method followed in the instant case. *Appeal of Russell Wheel & Foundry Co.*, 3 B. T. A. 1168. But it can not be said that there is no force in the petitioner's contention that this section should not be so construed, and in the further contention that if it is to be so construed there may be doubts as to its constitutionality.

A very large number of cases are now pending in the courts, before the Board of Tax Appeals, and in the Bureau of Internal Revenue in which the present question is involved. A decision by this Court in the present case will facilitate the disposition of these pending cases.

Respectfully submitted.

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